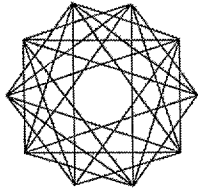


PD-ABQ-927
99433



P A D C O

Municipal Finance for Environmental Infrastructure Urban Policy Action Plan Fourth Annual Assessment

Prepared for
**United States Agency for International Development
Washington, DC**

Prepared by
**PADCO, Inc
Washington, DC**

Contract No PCE-1008-I-00-6008-00
Project No 9583 1

September 1998

Municipal Finance for Environmental Infrastructure Urban Policy Action Plan Fourth Annual Assessment

Prepared for
**United States Agency for International Development
Washington, DC**

Prepared by
**PADCO, Inc.
1025 Thomas Jefferson Street, NW
Suite 170
Washington, DC**

**Contract No. PCE-1008-I-00-6008-00
Project No. 9583.1**

September 1998



*Funds for production of this report were provided by the
United States Agency for International Development*

Executive Summary

The Municipal Finance for Environmental Infrastructure (MFEI) Housing Guaranty Loan Program provides the Government of Indonesia (GOI) with up to \$125 million in funding for urban environmental infrastructure investment over a four year period. Two associated technical assistance and training projects (the Municipal Finance Project, or MFP, and Private Participation in Urban Services, or PURSE) provide assistance to GOI in implementing an ambitious five-year Urban Policy Action Plan (UPAP). The UPAP charts GOI's course in decentralizing resources, authority and responsibility for increased infrastructure and service provision at the local government level.

Annual assessments of the MFEI are carried out by an independent expert to determine the degree to which UPAP targets have been met and to identify areas in which the MFEI implementation plan may require adjustment. This fourth annual assessment departs from the format of the three previous years in recognition of a) the impact of the economic and sociopolitical crisis that shook Indonesia during 1998 and b) the imminent completion of both PURSE and MFP. As requested by USAID, this assessment will, in addition to summarizing performance in meeting annual targets, provide comments on possible priority areas for continued USAID/GOI cooperation.

A Achievement of Targets for the Period

The emergence of Indonesia's financial crisis (known locally as the KrisMon) during the final year of the UPAP produced macroeconomic and sociopolitical conditions that, obviously, disrupted achievement of annual targets. This was particularly true with regard to debt and equity financing for municipal infrastructure. Nevertheless, key GOI officials, USAID staff and consultants all adapted admirably to the rapidly changing circumstances in the country in bringing the UPAP to an almost entirely successful conclusion.

The most significant potential outcome of the UPAP process, among other factors, is GOI's intention now to legislate decentralization through revision of the Basic Law on Local government as well as affiliated acts and regulations. The new government has focussed upon the need to break the KKN culture that flourished under the highly centralized environment nurtured by the previous regime. The legislation currently being drafted will apparently lead to local elections of mayors and councils and is, therefore, potentially a major step forward in establishing local autonomy.

While it would be presumptuous to claim that USAID support has been the sole driving force leading to these key legislative reforms, it is true that the financial and, probably even more important, technical support provided to GOI over the last 8 years has played a pivotal role in moving toward greater local autonomy. The challenge now for GOI, with continuing USAID and other donor support, will be to establish in the legislation a durable foundation of local autonomy while simultaneously working with local authorities and communities to mitigate the effects of the KrisMon.

The key UPAP objectives and summary achievements for the period are as follows

- 1) Strengthening GOI Apparatus for Urban Management (UPAP Obj 2)- key fourth year activities included support to formulation of the Urban Development Policy Framework that will succeed the UPAP in setting the GOI/donor agenda for work in the urban sector over the next five years City twinning arrangements were also formalized, although staff exchanges are now constrained by tight city budgets
- 2) Strengthening Local Government Urban Management Capacity (UPAP Obj 3)- development and delivery of all Urban Management Training Program (UMTP) modules to be covered by MFP was completed A subcontract was awarded and National Training Secretariat staff are transferring to the Urban and Regional Development Institute (URDI) which will provide a permanent base for the UMTP, which must be counted as one of the outstanding achievements of MFP
- 3) Implement a Decentralized and Coordinated Process for the Provision and Management of Urban Infrastructure (UPAP Obj 5)- PURSE targets under this objective were amended and achieved in previous years
- 4) Establish a Decentralized and Coordinated System for Urban Environmental Quality Management (UPAP Obj 7)- all targets under this objective were also achieved in previous years
- 5) Increasing the Availability and Effectiveness of Financial Resources for Urban Development (UPAP Obj 9)- the KrisMon effectively eliminated domestic financing opportunities for municipal infrastructure, and this situation will persist for some time Good progress was again made during the year in Inpres reform and this process is now to be complemented by a new Intergovernmental Fiscal Relations law which should establish a much higher degree of transparency and predictability in transfers to local governments
- 6) Mobilizing Private Sector and Community Participation in Urban Development (UPAP Obj 12)- while work continued with a number of potential PPPs around the country, the overall economic conditions in the country made finalization of deals very difficult Support continues to Bapennas in evaluating the need for a PPP center to promote transparent, productive public-private partnerships in terms of Kepres no 7 of 1998 Mobilization of community participation has been picked up as a key objective of Clean, and the model being developed through this project could have a major impact on GOI's efforts to address unemployment caused by the KrisMon in urban areas

B Key Opportunities

While the KrisMon has caused widespread suffering, it has also created a broad consensus in Indonesia that reforms are required throughout society. A central objective of the Reformasi agenda is dismantling of the highly centralized economic and financial decision making powers that typified the Suharto regime, and the move to decentralize government decision making to the local government (Tingkat Dati II) level is key to achievement of this objective. Thus, the KrisMon has opened a classic window of opportunity to institutionalize many of the decentralization objectives that, under the previous regime, could only be worked toward indirectly. But the KrisMon itself clearly demands the near term reorientation of priorities and resources to mitigate the effects of widespread urban unemployment. This assessment, therefore, focuses largely upon strategic ways in which USAID resources may assist GOI in melding its near and medium term objectives to mitigate the KrisMon while establishing a solid framework for Reformasi over time.

Key areas in which USAID appears to have significant comparative advantages in support of GOI include

- 1 Targeting Urban Unemployment utilization and expansion of Clean objectives and capacity to support community based investment programming should assist GOI in improving the effectiveness of Padat Karya. However, as discussed in the main body of this assessment, any realignment of Clean resources to mitigate effects of the KrisMon should, and can, be done carefully with the larger objective of supporting broad decentralization always as a top priority.
- 2 Support to Legislative Reform support is already being provided to GOI for reform of intergovernmental fiscal relations. But the larger task of defining the structure, electoral base and processes, modes of consultation and a variety of other key factors required for responsible local autonomy appears to be going forward without significant input based on international experience. While drafting of the basic law on local government is a political process, GOI would benefit from and USAID could help to supply inputs based on experience elsewhere that would strengthen this critical legislation.
- 3 Fiscal Transfers and Efficiency- as noted, Clean consultants have already been requested to support work leading to the new intergovernmental fiscal relations act. It will be very important for this act to both a) incorporate transparent and predictable formulae for revenue sharing and b) specify clear performance benchmarks to be met by local authorities in securing transfers in a responsible manner.
- 4 Capacity- once the Basic Law is agreed, there will be an enormous need for capacity building among officials to be elected locally. Experience in other countries has shown that training in principles of basic local governance needs

to be delivered before elections and assumption of duties by new officials. Given the UMTF developed through MFP and USAID's strategic emphasis upon democracy and governance, the mission appears to be uniquely well situated to provide this critical support to the decentralization process.

5. Local Enterprise Efficiency- Clean is again very well placed to support the efforts of GOI and donors to ensure continued PDAM operations. However, in order to have a lasting positive impact on PDAMs it will be very important to couple financial rescue packages with efficiency measures addressing management structures and practices, basic viability of smaller PDAMs, and important opportunities for non-capital private sector interventions. In addition, continuing USAID support to PPP development in the country should not overlook potential efficiency gains, and associated employment generation opportunities, which may result from private participation in the operations of other local enterprises (particularly markets, terminals and abattoirs).

C Summary

The UPAP reached a successful, if tumultuous, conclusion in 1998. While the effects of the KrisMon made issuance of municipal bonds impossible, all of the other key objectives of the program were met. Of equal importance to achievement of specific UPAP objectives, the capacity built and awareness created through the MFEI-affiliated programs has made a very significant contribution to preparing the ground for the formal process of decentralization that now appears to be imminent in Indonesia. Given USAID's long history of support to GOI and its unique positioning among donors through the ongoing Clean project, it is clear that future mission support could be critical in institutionalizing these gains in support of responsible, efficient local governments.

Once again, GOI and USAID staff as well as project consultants are to be commended for continuing their excellent management of this ambitious and complex program. Continuation and expansion of this solid working relationship should be of great utility in dealing with the immediate challenges brought about by the KrisMon and in supporting the critical decentralization agenda in the Reformasi period.

Fourth Annual Assessment

Municipal Finance for Environmental Infrastructure

September, 1998

Introduction

This annual assessment of the Municipal Finance for Environmental Infrastructure (MFEI) Housing Guaranty Loan to the Government of Indonesia was carried out over the period of September 7 through 25, 1998. In the course of the assessment more than 20 interviews were conducted with key GOI officials and consultants associated with the MFEI project.

This annual assessment has two main purposes. An external expert is requested, first, to review with all of the key parties progress made in achieving annual policy targets. These targets are very clearly set forth in the Urban Policy Action Plan (UPAP). The second purpose of the assessment is to allow all key participants to reflect upon the continuing appropriateness of established targets, identify emerging priorities, and consider possible realignments in both targets and deployment of resources through associated technical assistance and training activities.

The main body of the report contains two sections. First, overall progress in meeting UPAP objectives is summarized. Second, observations and suggestions are provided on critical areas of future cooperation between USAID and GOI given the new challenges presented by the KrisMon and the Reformasi agenda.

This assessment does not include a review of attributable GOI investments related to justification of HG tranche releases. That exercise has been conducted separately and the results are on file with USAID.

A sincere word of thanks is due to all of the GOI officials and project consultants interviewed during the assessment for their universal willingness to make available information and time from their busy schedules. Similar gratitude is expressed to USAID staff who were uniformly informative and highly efficient in organizing a rather hectic three weeks. Any errors of omission or misinterpretation in this report are entirely the author's.

Overview of UPAP Implementation

MFEI assistance, primarily through PURSE and MFP, was designed to support the five year UPAP implementation program that came to a close in 1998. With the advent of the KrisMon, the UPAP/MFEI objectives related to private financing of municipal infrastructure became unachievable as domestic interest rates surpassed 70% and capital sources dried up. While pilot municipal bonds were not floated, the rest of the ambitious

UPAP objectives were achieved. A review of these achievements will provide insight into the directions in which AID assistance to GOI can be of most utility in mitigating the effects of the KrisMon and supporting the Reformasi Process.

The overall goal of the UPAP, and MFEI assistance thereto, has been to develop the capacity of urban local governments in Indonesia to plan, finance and manage infrastructure and service provision. This goal was less than explicit in focusing specifically upon decentralization of authority, due to reservations within central government agencies under the previous regime as to the desirability of real decentralization. Indonesia had, after all, enjoyed decades of real economic growth and relative stability under the highly centralized planning and resource allocation system erected by the Suharto government. Given the country's size, regional imbalances, and diversity there was a sound argument that a fairly high degree of centralization was required to raise the various regions of the country to minimum levels of service provision and administrative capacity before local autonomy could be responsibly bestowed. As a result, increasingly complex, centrally driven development programs became the norm in the country during the '70s and '80s.

By the early '90s there was growing evidence that substantive decentralization was necessary to sustain economic development. Central planning of local service provision and infrastructure investment became increasingly inefficient particularly in rapidly growing urban local governments. As urban local governments grew their revenue bases became adequate to service debts for infrastructure investment, but these authorities required management skills and a regulatory environment within which responsible decentralization could take place. The result was the UPAP, which focused explicitly upon urban infrastructure investment and associated management and administrative capacity building.

USAID, beginning in 1989 through the Municipal Finance and Shelter Program and--since 1994--through MFEI, has been the main international supporter of GOI's policy reforms to strengthen the capacity of municipal governments in Indonesia. The considerable achievements of these reforms have been chronicled in previous annual assessments¹. The GOI summary of UPAP achievements specifically for 1998 is attached to this assessment as Annex 1. Taken as a whole, the UPAP reforms have both significantly improved the capacity of urban local governments to manage their affairs and provide key indicators for future assistance and cooperation. Accomplishments in UPAP implementation can be summarized as follows:

First, UPAP implementation has generally raised the level of awareness in central and local government as to the interlocking nature of reforms required to support responsible decentralization and efficient investment in municipal environmental infrastructure. In many countries the need for coordinated reforms in the administrative/regulatory, fiscal, financial, and human resources realms is underappreciated. The result, in many cases, is ineffective decentralization. Through the UPAP, GOI has embarked upon a well-coordinated path to decentralization. This integrated approach will need to be sustained.

DeGroot D. G. 1995, 96 and 97 MFEI Annual Assessments

and broadened to include particularly, reorientation of central ministries to new roles as facilitators rather than directors

Second, the UPAP's emphasis, through the UMTF, on management—rather than purely technical—training addresses one of the key prerequisites to successful decentralization. Delegation of authority to local governments that possess limited management capacity will negate anticipated efficiency gains and can lead to recentralization. As GOI's program of decentralization accelerates, the requirement for local government capacity building will accelerate correspondingly, and USAID appears to be well positioned to provide support in this regard.

Third, implementation of the UPAP components which addressed debt and equity financing of local government infrastructure brought a much greater degree of clarity to the complexities of creating this type of domestically driven market. MFEI support, through PURSE for equity and MFP for debt financing, recognized that the lack of experience in Indonesia with domestic financing for municipal infrastructure posed a variety of challenges. Even though during most of the UPAP implementation period domestic finance was generally available at bearable rates, actually floating bonds and bringing equity deals to fruition proved to be very difficult processes. The debt and equity financing goals of the MFEI are now, at least for the time being, on hold due to the KrisMon. One of the clearest lessons learned through UPAP implementation is that there are still an abundance of "market imperfections" to be dealt with before reliable markets for debt and equity financing of municipal infrastructure can operate in Indonesia.

A final key conclusion arising from MFEI support to implementation of the UPAP is that the success of an accelerated decentralization process will have a large bearing upon the speed with which Indonesia recovers from the KrisMon. It is arguable that a critical contributing factor leading to the present crisis was the very high level of corruption, cronyism and nepotism (KKN) which has typified the country in recent years. The potential for high levels of corruption is, of course, greatly increased by a highly centralized, relatively opaque resource distribution system. While decentralization alone (or any other single factor, for that matter) will not stamp out KKN, the potential for very large scale diversion of resources to unproductive applications is minimized when allocation processes are made more accountable through participation and scrutiny at the local level. Thus, a key to economic recovery in Indonesia will be the extent to which the now explicit decentralization process results in true participation and accountability, rather than simple deconcentration of opaque allocation decisions through local structures.

It is in this regard that USAID, given its long history of fruitful dialogue with and support to GOI, appears to have the highest degree of comparative advantage among international donors. While the immediate affects of the KrisMon may be mitigated to a certain extent by focussing on employment generation, the medium term recovery of the economy and country as a whole will be durable only with the achievement of efficient local investment decision-making processes within contexts of true accountability. In the following section of this assessment, recommendations are made to GOI and USAID as

to those areas in which AID's resources may be best utilized to assist the Indonesian recovery process

Key Opportunities

Interviews carried out with officials, particularly in MOF, Bapennas and MOHA, indicated that GOI is in the process of identifying the areas in which USAID, and other donor, assistance may be of the highest utility in the near and medium terms. USAID is, of course, actively assisting this evaluation by reexamining a) the comparative advantages of USAID vis a vis other donors, b) the resources AID already has in place, and c) the resources AID may be able to mobilize to further assist GOI. The following opinions as to the key areas in which USAID support may be most valuable are entirely those of the author, and in no way imply any commitment on the part of USAID or decisions on the part of GOI.

The key **comparative advantage** of USAID support to GOI would appear to be the well founded working relationship focused on the broad sectoral reforms necessary to promote responsible decentralization. While other donors have assisted GOI in this respect, AID's program of assistance has, since 1989, clearly been the most comprehensive and long standing of all donor efforts. AID already has substantial resources in place through the Clean contract including knowledgeable policy advisors. In addition, the Mission could marshal additional resources through Clean, other contracting mechanisms, and even through related programs within the Mission's existing portfolio (for instance, Democracy and Governance).

Key ministerial officials are facing unprecedented challenges in dealing with the effects of the KrisMon. In less critical times, these officials have had the capacity to deal with a wide variety of donors each addressing specific aspects of urban/municipal development and decentralization. With the advent of the KrisMon, however, it would appear to be incumbent upon GOI officials to limit the amount of time spent satisfying the requirements of various donors in order to focus on managing the crisis. Therefore, GOI should consider organizing donor support in such a way that "lead" donors take overall responsibility for coordinating support activities in critical areas as identified in consultation with GOI. For instance, given the increasingly onerous consultancy procurement requirements within the World Bank, it would make little sense for the Bank to have a lead role in securing policy advisory services. By the same token, given the huge backlogs in undisbursed capital funding already committed by the Bank, ADB and others, it would make little sense for AID to devote considerable effort to securing additional capital funds.

AID's clearest comparative advantage would, therefore, obviously be in the area of assistance to the continuing decentralization reform process. GOI may find it necessary to seek AID support in other areas. The Mission, of course, may need to be responsive to priorities within the Agency. But the maximum beneficial impact for the country as a whole is likely to be achieved by continuing to focus AID support firmly on the historic window of opportunity presented by GOI's new resolve to accelerate substantive

decentralization. Within this overall context, the following areas emerged during the annual assessment as key areas of AID support to GOI

1 Targeting Urban Unemployment

By all accounts the KrisMon has caused very substantial new unemployment among the urban work force. While estimates vary widely, there appears to be little doubt that millions of formal sector wage earners have already lost their jobs, and some analysts expect many more to follow suit as additional businesses succumb to the effects of the crisis. The fact that the crisis is having the greatest adverse impact on formal sector, urban wage earners is all the more alarming as these workers tend not to have access to the informal safety nets typical in rural areas. The specter of millions of unemployed urban Indonesians with no livelihood alternatives resorting to crime and violence has rightly caused deep consternation throughout the country.

GOI has attempted to respond to this situation in a number of ways, including through Padat Karya programs which have provided funding for local infrastructure projects intended to generate temporary employment. So far, however, these programs have been plagued by a lack of data required to target the population most adversely affected by the KrisMon. Without delving into details, there appears to be wide acceptance within GOI that the first round of Padat Karya projects did not efficiently reach the intended beneficiaries.

Given the size of Indonesia's urban population and the sprawling settlement patterns of many cities in the country, it is hardly surprising that the newly unemployed workers are difficult to locate. Cipta Karya has employed consultants to prepare detailed maps of unemployed populations, but it is unclear whether the data collection techniques (apparently mainly of a secondary nature) upon which this work is based will yield useful results.

In this type of situation, and especially as time is of the essence, perhaps the best targeting method is self-reporting from the local level. One of the key objectives of the Clean project is to promote demand driven infrastructure investment projects in urban areas. AID and GOI have sensibly recognized that this element of Clean, for which consultants are already in the field, can be adapted to assist the generation of projects which provide needed infrastructure in areas with high concentrations of newly unemployed people. While the original intention of this element of Clean had been more to demonstrate the community driven infrastructure planning process than to generate large numbers of projects and associated jobs, available resources within the Clean project are now being mobilized to deliver more employment opportunities. Coordination with the World Bank, ADB and other donors is underway to ensure that funding is available for the projects generated by Clean.

While this joint effort is commendable and could potentially improve the efficiency of Padat Karya investments in meeting emergency employment needs in sound manner, several caveats and potential risks should be considered.

- a **Needs should be locally identified** The first round of Padat Karya projects showed that there is uneven demand for employment generating projects around the country. Anecdotal evidence indicates that many of these first round projects did not attract newly unemployed persons, presumably because these persons were simply not present in all local authority areas. This is understandable given that the KrisMon is adversely affecting particular types of businesses (finance, construction, manufacturing) which are unevenly distributed. Therefore, for the Clean approach to work in generating jobs where they are needed most, it will be necessary for GOI to resist political pressures to broadcast funding in the manner of the first Padat Karya disbursements. This will call for a more analytical approach in the central funding and planning agencies.
- b **Investments should address real community needs** Local political pressures may result in resistance to truly community driven project identification and implementation. This is a problem which Clean would have presumably addressed in a gradual, interactive manner under the originally conceived demonstration approach. By accelerating the project packaging process to address unemployment, there is a clear risk that the more labor-intensive community driven approach will be short-circuited. In such cases, the efficiency of the investments will be diminished, as appears to have been the case in many instances with the first round of Padat Karya. Community oriented infrastructure initiatives often deal with this potential problem by establishing with local authorities from the outset that communities must have the final say on investment decisions, within reasonable bounds including approval by local authorities of responsibility for any downstream operations and maintenance costs.
- c **Funds must be available** While donor coordination is always admirable, it is also risky particularly when one source of funding is used to prepare projects to be funded from another source. As the facilitators of the employment generating projects, Clean personnel will have their credibility on the line. Thus, coordination with all providers of capital investment funding, both donors and GOI, will require close attention. For donor funds in particular, disbursement and procurement conditions should be closely examined. The World Bank, for instance, has a variety of requirements with regard to i) counterpart funding, ii) advance payments or reimbursements, iii) thresholds for no objections and different types of advertisement of tenders, etc. Ideally, GOI will be able to work with the various suppliers of capital to establish a common pool of funds available for project finance under common, simple terms. Useful examples of simple guidelines for community initiated projects may be drawn from World Bank assisted projects in Zambia (the community project component of the Urban Rehabilitation and Water Supply Project) and Zimbabwe (the district development grant component of the Rural District Council Capital Development Project) among others. In the Zimbabwe project capital funds from the Bank, SIDA and the Dutch government are pooled and administered under one set of guidelines known as

the DDG Operational Manual (copy furnished separately to AID) The AFTU1 division manages both of these projects

- d **Clean should not be over burdened** While Clean does provide a convenient and timely vehicle through which assistance for project preparation can be readily mobilized, dedication of resources for this purpose should not be at the expense of Clean support to the larger decentralization reform process over the medium term If adequate resources are available to AID it would seem to be preferable for Clean to facilitate establishment of an efficient delivery system for employment generating projects, and then for AID to provide additional human resources to sustain this system as required Clean should then be allowed to return to its policy reform, community-based infrastructure planning, and capacity building objectives

To summarize, there is no question that employment generation by the most effective means possible is a critical short term objective in managing the KrisMon While the Clean project is a convenient and effective means through which near term assistance may be provided, that project should not be compromised in its ability to fully support the larger decentralization reform process Rather, Clean should be used to help define the model for delivering community driven, employment generating projects the technical assistance requirements for which should then be supplied through AID mechanisms (such as IQCs) with Clean returning to its core task of promoting sustainable decentralization

2 Reformasi and Support for Decentralization

The Clean project was designed on the assumption that the gradual program of capacity building and regulatory reform that typified the UPAP would continue over the next four or five years This assumption is reflected in the deployment of Clean resources, including continuation of senior advisory positions in MOF, MOHA and Bapennas With the UMP fully designed and implemented under MFP, Clean's capacity building focus was shifted to supporting community participation in infrastructure investment planning and implementation at the local government level This well conceived design has now, of course, been overtaken by events

Given the fluid situation in Indonesia, it is difficult to prognosticate with any degree of confidence as to the course events will take over the next several years One scenario that repeatedly arose during interviews with GOI officials is that management of the KrisMon will dominate government policy for two to three years after which full attention will shift to implementing Reformasi In fact the Reformasi process is already underway in key sectors For instance Bapennas and the ADB have already framed a thorough reform program for the power sector, and are working on similar reforms for the telecommunications and energy sectors In the opinion of a senior Bapennas official, a similar exercise is needed for the decentralization process

MOF officials share this opinion, stating that to date the decentralization policy seems to be limited to a general focus on "more autonomy", without any real agreement in GOI as

to the preferred options for achieving this goal. It is hardly surprising that a consensus is lacking on the most efficient and equitable means to achieving decentralization, given the country's lack of experience with any form of government other than a sort of centralized autocracy. Revision of the Basic Law on local government should provide a golden opportunity for Indonesian politicians and government officials to openly debate principles of decentralization and learn from experiences elsewhere.

Unfortunately, it does not appear that this sort of debate is taking place. Instead, a number of different drafts of the Basic Law are being prepared by central government agencies with each draft presumably reflecting each agency's specific concerns. It is, of course, arguable that basic sectoral legislation is a political, and therefore, purely internal matter. However, given the lack of experience in GOI with substantive decentralization, a more persuasive argument can be made that the maximum amount of information possible should be made available in the process of revising a law of such critical importance. A number of officials interviewed during the annual assessment made exactly this point, and expressed serious reservations about the current process that seems to be almost wholly political in nature.

Relations between GOI and international donors have traditionally been somewhat formal with clear boundaries on levels and types of appropriate assistance and intervention. These boundaries may have been sensible when the economy was growing and management challenges faced by GOI were largely familiar. However, with the KrisMon and the Reformasi process GOI is entering into unfamiliar waters. Government officials have no experience with managing economic crises, unlike their counterparts in many other developing countries. Further, officials do not seem to be driving the Basic Law on local government revision process. Rather, politicians and the armed forces appear to be playing central roles and it would seem unlikely that representatives of these groups would be broadly familiar with decentralization principles and options.

It may, therefore, be opportune for international donors to at least offer to support a forum of some kind that would bring together local and national political leaders, government officials and representatives of civil society. The purpose of such a forum would be to fully consider the variety of options for decentralization, and to approach revision of the Basic Law as the first step in a process which will be guided by a core set of agreed principles. The consultative process followed by the Local Government Forum in South Africa may be instructive, both substantively and procedurally. Reform of the Local Government Code in the Philippines in the early '90s may also provide useful inputs.

In addition to offering support, donors may wish to consider (and may already be doing so) linking capital financing to specific reforms or reform processes with regard to decentralization. While tied aid is not usually a preferable approach, a dysfunctional Basic Law on local government would be even less desirable.

Given its longstanding support for policy reform related to decentralization and the Clean resources already in place, USAID is the logical donor to organize support for the

informed revision of the Basic Law. Such support need not be particularly extensive or expensive. Focused expert input to an interagency working group of senior officials and politicians could be delivered through a limited number of workshops focused on achieving consensus on basic principles. Indirect support could also be provided by remote review of and comment on proposed drafts of the Basic Law by recognized experts. The impetus for this sort of support needs to come from GOI, presumably through a joint initiative of at least MOF, MOHA and Bapennas. Given the intended legislative schedule—a final draft Basic Law is anticipated to be in Parliament by December—this assistance package needs to be organized quickly. Clean appears to be an ideal delivery vehicle for this assistance provided modest additional resources could be made available by AID.

3 Fiscal and Financial Reforms

While the Basic Law on local government will obviously be the cornerstone of decentralization in Indonesia, the bricks and mortar of this sectoral reform will appear in a variety of acts and guidelines following from the Basic Law. Normally, these subsidiary acts would be detailed only after the overarching legislation is in place, or at least fully agreed. However, due to the urgency with which GOI views the need for decentralization, a number of subsidiary acts and regulations are being revised even as the Basic Law is still being drawn up. Key among these is the Intergovernmental Fiscal Relations Act which will define the basis for revenue sharing between the center and local authorities.

Clean has already been requested by GOI to support revision of the Fiscal Relations Act and senior advisors are now working with government. Following are comments, some or all of which may already have been taken into account, based on similar reform work carried out in other countries. The interconnection between fiscal reforms and local government financing options is also discussed.

- a **Transfers must be transparent and predictable.** While revenue sources and sharing systems vary greatly from country to country, the common keys to successful transfer systems are transparency and predictability. Local governments can only achieve investment efficiency gains if they are able to plan and implement investment programs in an orderly manner. The need for transparent and predictable transfers is even more important in countries such as Indonesia where central transfers constitute a significant portion of local budgets. Therefore, while the current debate in Indonesia appears to be focussed mainly on the formula(e) to be applied in revenue sharing, it will be equally important to ensure that these formulae, once agreed, are straightforward and are administered in a timely, predictable fashion.
- b **Incentives are required to achieve timeliness.** Achieving timeliness and predictability of fiscal transfers can be difficult. There are natural tendencies in central bureaucracies, especially in highly centralized situations like Indonesia, to be unenthusiastic about directly handing over resources to local governments especially when the allocation of these resources has been a

source of substantial power in the past. While it may sound mundane, the key to achieving timely transfers often rests with redesigning career incentives for central administrators to reward transfer efficiency. Without such incentives, central transfers almost inevitably become opportunities for rent seeking. In a geographically dispersed country like Indonesia, the transaction costs to local governments required by repeated travel to the capital to secure transfers can be very burdensome. Thus, well-designed transfer formulae must be complemented by efficient, transparent transfer procedures in order to achieve the desired results.

- c) **Transfers must be linked to local government accountability.** Shared responsibility is inherent in any fiscal transfer system. Central government has the responsibility to collect and transfer revenues efficiently and equitably. Local governments bear equal responsibility for ensuring that resources are invested responsibly and productively. And, central government retains a fiduciary responsibility to monitor local government performance in this regard. Experience has shown that monitoring of specific local investments, on a project by project basis, by central authorities is often neither efficient nor effective. On the other hand, monitoring the process by which local authorities plan and implement investments, and generally manage their affairs, can lead to more effective local governance in general. It is useful, therefore, to include in fiscal transfer system designs clear benchmarks that must be achieved by local governments in order to qualify for continuing transfers. Examples of benchmarks of local government performance which are in use elsewhere include

- i) preparation of and adherence to rolling capital investment programs that have been arrived at through open consultative processes (this is a key Clean objective),
- ii) implementation of sound operations and maintenance investment plans,
- iii) transparent local procurement procedures, which may be oriented to labor intensive contracting in countries, like Indonesia, where employment generation is a priority,
- iv) timely preparation and publication of annual audited accounts,
- v) efficiency in previous utilization of fiscal transfers

This list is not exhaustive, but it does indicate the kind of higher order performance indicators that are susceptible to monitoring by the center without subverting the core objective of increased autonomy in local decision making. Again, experience in other countries has shown that clear performance benchmarks should be included in transfer systems from the outset, as it can be politically difficult to retrofit these requirements at a later date.

- d) **Clear fiscal transfer systems can obviate the need for other centrally administered financing mechanisms.** One of the important effects of predictable fiscal transfers is improved creditworthiness for local governments. Predictable transfers come to be regarded by financiers as virtual own source revenues and, thereby, enhance the borrowing capacity of

local authorities. When central governments take the necessary steps to implement clear fiscal transfer systems, an implicit assumption is that local authorities are expected to become increasingly autonomous in securing long term credit for, particularly, economic infrastructure investments. The center does not entirely abdicate responsibilities in this regard, especially in cases—like Indonesia—where substantial regional resource and development disparities exist. However, in many cases where fiscal transfer systems have been mutually agreed by central and local authorities, the role of the center as a financing intermediary is very much reduced. While this issue is not currently a top priority in Indonesia, given all the other pressing challenges, it should be borne in mind particularly as consensus is formed on the transfer systems. One aspect of this consensus should be that when transfer systems are fully functional, local autonomy has been expanded through the Basic Law, and the economy is on the mend, then central intermediary mechanisms—like the RDA—should no longer be required. Serious consideration should then be given to eliminating central government liability for the RDA, which constitutes a significant disincentive for local governments to meet the requirements of market finance.

Once again, AID's assistance to GOI through Clean is extremely well placed to support delineation of an equitable, responsible system for fiscal transfers. The amount of support which Clean can provide to this critical undertaking may, however, be constrained by the additional responsibilities assigned to project personnel involved in the community infrastructure/employment generation initiative. AID may want to examine, therefore, the need for additional resources to fully support GOI's reforms in the Basic Law, the Intergovernmental Fiscal Relations Act, and associated acts and guidelines which will be of such importance in determining the success of decentralization in Indonesia.

4 Capacity

The near term likelihood of thousands of newly elected local government officials throughout Indonesia poses a daunting challenge in terms of building capacity for responsible local governance. Again, and without unduly reiterating previously made points, decentralization succeeds in achieving its multiple objectives only when local governments have the capacity to responsibly exercise their new authority. In countries, like Indonesia, where local officials have always been appointed by the center, there is by definition no reservoir of politicians who are experienced in the practicalities of local governance. In these situations, there is a clear need to support building of management capacity among newly elected officials. AID, with its existing Democracy and Governance strategic objective, is probably uniquely placed among donors to assist in meeting this need.

There are, no doubt, many recent examples of this type of capacity building program from countries, for instance, in central Europe. Another example that may be of utility is the training program for prospective local officials supported by AID in South Africa.

That program provided training for thousands of local leaders before local elections, on the premise that once officials were in office it would be more difficult for them to focus on training. This approach worked very well, indeed, the deputy Director General of South Africa's Dept. for Constitutional Development has called the pre-election training program a "life saver" in terms of the relative efficiency with which formerly disenfranchised black South Africans have been able to move into positions of responsibility.

In other countries newly elected local officials are required by central government to undergo training. The imposition of such a requirement runs counter to local autonomy but can also be effective. In either case, pre- or post-election training in the basic principles of local governance will be extremely important in ensuring that autonomy is responsibly exercised.

5 Local Enterprise Efficiency

Clean is providing assistance to improving PDAM efficiency in several key ways, including consolidation of non-viable water companies and a continuing focus upon improved management. The advent of the financial rescue package to ensure that all PDAMs during the KrisMon maintain minimum levels of operations presents new opportunities, and risks, to improve PDAM efficiency.

The main risk presented by the rescue package is that poor management will be rewarded with operating subsidies. While it will obviously be very difficult to raise tariffs during the KrisMon, by many reports there are still considerable efficiency gains that could be achieved by PDAMs. Chief among these appears to be reduction in water losses, either through direct leakage in the ground or through administrative leakage by failure to collect particularly from government agencies. Clearly, any provision of operating subsidies should be linked to a required focus on efficiency gains.

According to responsible MOHA personnel, however, while funding for operating requirements will be made available from several multilateral sources, resources are lacking for technical assistance to improve PDAM management. The resources required would likely be substantial. Teams of consultants would probably need to work with up to one hundred PDAMs around the country. This level of funding may exceed AID's capacity, but MOHA has clearly expressed the need for assistance in framing such a program and then raising funds from appropriate sources.

A key opportunity also presents itself with regard to PDAM efficiency. During more prosperous times, many local governments were reluctant to confront PDAM efficiency issues as the companies provided important cash flows to local government. In the absence of PDAM profitability, however, local governments may be more willing to examine the option of privatizing parts of PDAM operations to achieve greater efficiency. Through follow on work from PURSE, AID may be well placed to assist, particularly given the effects of the KrisMon which have undoubtedly driven many local businesses to search for new income opportunities. Thus, AID may wish to explore

refocusing its support for PPPs from major equity deals to the more prosaic, but nonetheless important, potential to promote smaller scale, management contract approaches to improving efficiency in PDAMs as well as other local economic enterprises

Summary

The KrisMon has visited great suffering on the people of Indonesia, but it also has precipitated new opportunities for fundamental reforms which will, if executed properly, significantly improve the country's prospects over the medium term. AID's greatest comparative advantage in assisting the reform and rebuilding process clearly lies in supporting responsible decentralization. While important assistance can be provided to short term ameliorative measures, it is strongly recommended that AID remain focussed, as it has for the last decade, on assisting the emergence of responsible, efficient local authorities through which the needs of all Indonesians can be more effectively met.

At this point in Indonesia's history there is a clear need to explicitly link objectives to improve the quality of governance with the capacity of government to provide critical services and infrastructure. This explicit linkage is, for whatever reason, not typically present in AID mission programs. The Jakarta mission has the opportunity to break important new ground by creating this link to bring the "softer" aspects of good governance into consonance with the more technical objectives of infrastructure provision, fiscal reform, and enterprise management efficiency. Coordination between these two strategic objectives could provide a new model for AID programming elsewhere, but more importantly this coordination may be the critical variable in determining the degree to which Indonesians receive the accountable, efficient, decentralized government their futures require.

Attachment

**REPORT ON
PROGRESS IN IMPLEMENTATION OF THE
GOI URBAN POLICY ACTION PLAN,
YEAR FOUR, REPELITA VI
(APRIL 1997 - MARCH 1998)**

Prepared by

Bureau for Urban Development, Public Housing, Human Settlements

and Spatial Planning, Deputy V, Bidang Regional dan Daerah

BAPPENAS

as a Background Note for the

Disbursement of the Third Tranche of the USAID Municipal Finance

for Environmental Infrastructure Housing Guarantee Loan

(A I D Loan No 497-HG-003)

May 4, 1998

**REPORT ON PROGRESS IN IMPLEMENTATION OF THE GOI URBAN POLICY
ACTION PLAN, REPELITA VI, YEAR IV
(FOR THE PERIOD APRIL 1997 TO MARCH 1998)**

Introduction

This report has been prepared to summarize the accomplishments associated with the fourth year of the GOI/USAID Municipal Finance for Environmental Infrastructure (MFEL) Housing Guarantee Loan. Its purpose is to identify accomplishments in implementing targets in the GOI Urban Policy Action Plan during the fourth year of Repelita VI and PJP II that are supported by USAID under the Municipal Finance Project (MFP) and the Private Participation in Urban Services (PURSE) Project. This report relies upon working documents of the MFEI programs and data provided by GOI staff from the Ministries of Finance, Home Affairs, Public Works, and BAPPENAS. It should be noted that this report covers only those aspects of the GOI/UPAP directly relevant to the work programs of MFEI. In effect, however, it serves as a comprehensive preliminary assessment of select urban policy initiatives by the GOI for year four of Repelita VI.

This report addresses selected MFEI fourth years targets and accomplishments under the following six objectives of the UPAP:

- ◆ Enhance the regional finance system to increase the availability and effectiveness of financial resources for urban development (UPAP Objective 9)
- ◆ Establish a decentralized and coordinated system for urban environmental quality management (UPAP Objective 7)
- ◆ Strengthen the institutional capacity of local governments for urban management (UPAP Objective 3)
- ◆ Strengthen the governmental administrative apparatus for urban management (UPAP Objective 2)
- ◆ Implement a decentralized and coordinated process for the provision and management of urban infrastructure, facilities, and adequate levels of investment (UPAP Objective 5)
- ◆ Mobilize private sector and community participation in urban areas (UPAP Objective 12)

1 **ENHANCE THE REGIONAL FINANCE SYSTEM TO INCREASE
THE AVAILABILITY AND EFFECTIVENESS OF FINANCIAL RESOURCES
FOR URBAN DEVELOPMENT (UPAP Objective 9)**

Under this objective, the GOI seeks to accomplish the following results a) improve the system of intergovernmental grants, transfers and subsidies to support national development targets, b) reduce the reliance of local governments (Dat I and Dat II) on intergovernmental transfers through improved own source revenue mobilization, and c) establish a credit system for urban infrastructure and housing investments that makes use of long-term financing instruments secured through the capital markets

MEDIUM TERM GOAL

9 1 Improve the system for allocating intergovernmental grants, transfers and subsidies

ACTION

9 1A Improve the overall system for allocating intergovernmental grants, transfers and subsidies to local governments in order to incorporate a) better targeting to low-income beneficiaries, b) more local government discretion to allocate funds to priority sectors based on local needs, c) incentives for local government to generate greater own source revenues, and d) increased sharing of revenue sources with local governments

4TH YEAR TARGET

Study of local utilization of block grants conducted Results disseminated to support program strengthening

ACCOMPLISHMENTS

In June and July 1997, MFP-sponsored short-term consultants Dr. Larry Schroeder (Indiana University), Dr. Iwan Jaya Azis (University of Indonesia and Cornell University), and Kismet Kosasih (Consultant) assisted the MFP/Bappenas Urban Development Advisor to study 12 cities and urbanizing districts regarding their access to and utilization of INPRES Dati II grants. Specific issues addressed by the study included the following: 1) how closely does the current allocation of INPRES grants conform to local development needs and priorities, 2) does the current system enhance or hinder technical and economic efficiencies in implementation of local development programs, 3) how much local discretion is built into the current INPRES allocation system, 4) what further changes in INPRES Dati II grants would foster better technical and economic efficiencies, and 5) how the GOI might better assess the impacts of the INPRES program in the future on an ongoing basis. The study sites included a range of sizes and levels of development, although all were participants in the GOI's pilot program for regional autonomy. They included the cities of Ujung Pandang, Samarinda, Mataram, Bandung and Padang, and the districts of Gowa, Kutai, Lombok Tengah, Bandung, Sidoarjo, and Tanah Datar.

Eight Dati II were selected for site visits by the research team to collect additional data and also to administer a survey to select local leaders regarding the functioning of the current INPRES system (viz-a-viz local development needs) and what changes they would advocate to improve the system. The survey found that none of the localities view the existing system of INPRES Dati II allocation as suitable for the success of the decentralization process, and that a shift to a more discretionary block grant is consistent with local expectations regarding the implementation of decentralization policies. Quantitative and qualitative data indicated that local governments use the INPRES funds generally as specified by central government but that the increase in the number of earmarked grants has produced an unwieldy array of central government guidelines for expenditure of INPRES funds that has negative implications for expenditure and allocative efficiency at the local level. The study found that there seems to be annual shifting of allocations at the local level which suggests that local governments exercise discretion in the allocation of those portions of the INPRES grants that are under their control. By shifting the entire INPRES grant system towards block grants seems to be consistent with the expectations and the capabilities of local governments to play a greater role in guiding local development.

A summary of the study was presented by Dr. Azis at the MFP National Policy Seminar on Effectiveness and Efficiency of Local Government Expenditures in Padang, West Sumatra, September 22-24, 1997. The paper, entitled "Effectiveness and Efficiency in Utilization of INPRES Dati II: A Local Perspective," indicated that there was a near unanimous preference on the part of local governments for an increase in the discretionary authority to link INPRES allocations to local priorities.

The results of the INPRES research project, and the discussions conducted during the National Policy Seminar, served as the basis for a set of recommended strategies for strengthening the INPRES system prepared by MFP and set forth in a memorandum to Deputy V Bappenas on October 21, 1997. The recommendations included the following: a) enlarge the INPRES Umum (or block grant) portion by consolidating select INPRES Khusus (earmarked) grants under the Umum category, b) combine several other INPRES Khusus and Non-DIP grants into a "sectoral block" to ensure that central government priorities in

allocating funds to sectors is preserved but to allow more local discretion for spending within those sectors, c) create several additional INPRES Khusus grants to support decentralization activities, and d) revise and clarify additional allocation criteria for all INPRES grants. It was also recommended that the previously pursued practice of converting select DIPS to INPRES funds be continued by shifting approximately Rp 2 971 trillion in DIPS to INPRES between FY 1998/99 and FY 2000/01.

MFP supported a National Policy Seminar on Intergovernmental Fiscal Relations in Surabaya from March 25-27, 1998. The keynote presentation by Kenneth Davey, University of Birmingham, was "Central Local Financial Relations," and was complemented by presentations by Nick Devas, "The Subsidi Daerah Otonom: A Review of the Issues," Dr Blane Lewis, "Intergovernmental Fiscal Relations and Urban Infrastructure Finance in Indonesia: Long-term Trends, Short-Term Prospects, and Policy Implications," Simon Delay, "The KKD Program and Human Resource Development in Regional Finance," and Brian Binder, "Regional Finance." The outcome of the seminar was the conclusion that implementation of a new intergovernmental finance law is more urgent than it has been in recent years.

MEDIUM TERM GOAL

9.2 *Enhance local government resource mobilization*

ACTION

9.2A Improve local government revenues from local taxes and user charges

4th YEAR TARGET

Continue increases in real per capita local government taxes and user charges as measured through select monitoring indicators

ACCOMPLISHMENTS

Data indicate that Own Source Revenues, as a proportion of total local government revenues, have been between 26.5% and 27.6% over the past three years for which data is available (FY 1992/93 - FY 1994/95). This is slightly lower than the proportion in the early 1990s. In terms of real per capita Own Source Revenue, however, there has been an overall increase of 50% over the past five years, from Rp 9,465 in FY 1990/91 to Rp 14,186 in FY 1994/95. Thus, it is not a lack of growth in Own Source Revenue mobilization, but rather the relatively more rapid increase in intergovernmental transfers that has diluted somewhat the statistical impact of OSR increases overall in the past few years.

A special report, "Financial Performance in Cities, 1990-1998," was prepared under MFP to determine how an "urban subset" of Dati II performed in comparison to local governments as a whole. The urban subset used was the 50-plus official cities (kotamadya) and this subset was divided according to three different city categories: large cities (greater than 1 million residents), medium cities (200,000 to 1 million residents), and small cities (less than 200,000 residents). One of the most significant findings of the analysis was that the increase in real per capita Own Source Revenue was nearly 22% lower for cities than for Dati II as a group from FY 1992/93 to FY 1994/95. Thus while real per capita Own Source Revenue has increased in cities, it has done so at a pace slower than for all Dati II. Only sixteen out of 51 cities (31%) had a real per capita Own Source Revenue that exceeded the Dati II average in FY 1992/93. A slightly smaller proportion of cities had higher than average real per capita Own Source Revenue in FY 1994/95. This may be explained by the substantially larger taxable land area of kabupaten versus kotamadya, the lower population density of kabupaten, and the generally solid performance of local governments in general in

increasing property tax revenues. Between FY 1992/93 and FY 1994/95, the major source of Own Source Revenue shifted from other non-tax revenues as the predominant source to a greater reliance upon property tax revenues. Overall-non-tax local revenues grew by only forty percent during this period which was substantially less than growth in property tax revenues.

The study also found that large cities were most successful in Own Source Revenue generation. This group derived 47% of total revenue from local sources in FY 1994/95, as contrasted with 35% among medium cities, and just 27% among small cities. Several case studies revealed that the average percentages mask rather divergent patterns among cities in the same category. For example, Surabaya derived 67.5% of its revenues from local sources in FY 1994/95 whereas Bandung derived only 52.2% from local sources. In Ujung Pandang, the newest comer to the large city category, only 24.5% of total revenues comes from local sources. Given its location in the less economically developed Eastern Indonesia, the lower rate of Own Source Revenue may be connected to the overall lower level of economic development. The medium cities showed modest increases in Own Source Revenue, with some actually experiencing a decline. The level of Own Source Revenue in small cities is low but steady improvements between FY 1992/93 and FY 1994/95.

ACTION

9.2D Improve financial management of local water companies (PDAMs)

4th YEAR TARGET

Continue to assist in updating monitoring system and database on PDAMs for use in project identification and project screening.

ACCOMPLISHMENTS

MFP assisted in the annual update of the monitoring system for PDAMs in PUOD, a system which is linked to annual assessments of the financial performance of the PDAMs by BPKP through an audited account. Data from this monitoring system was also used to prepare an analysis of loan repayments by PDAMs. The addition of a "benchmarking system" through support from the World Bank, is under consideration. Not only would this expand the data base to include operational data (as well as financial data), but could be used to develop a rating system to guide the government and PERPAMSI in future loans (through SLAs and RPDs) to PDAMs.

ACTION

9.2E Improve cost recovery of other local government services (e.g. solid waste, parking, hospitals, licenses, permits, etc). Includes analysis of organization options, operational efficiency, tariffs, etc.

4th YEAR TARGETS

a. Conduct 2 pilot projects on conversion of dinas to local enterprises in two different services.

b. Conduct national policy seminar on local government expenditure efficiency.

ACCOMPLISHMENTS

a. Several prior MFP II outputs supported achievement of this target, including a draft report on the policy rationale, criteria and process for converting local government service to local government enterprises by Dr. James McCullough, RTI (presented at the October 1996 national policy seminar), an MFP II-BAKD study on the financial performance of local government sanitation and parking enterprises completed in April 1997, and discussions between staff at BAKD/MOF and Subdit Bina Perusda/MOHA to identify two

suitable candidates as pilot sites for "corporatization" of a dinas

Initially, the two dinas' identified as candidates for conversion were the Dinas Kebersihan (Cleaning) in Kotamadya Bengkulu and the Dinas Pasar (Market) in Kotamadya Bogor. Assessment of the feasibility of the Bengkulu project was done in conjunction with the current GTZ Bengkulu Water Supply and Sanitation Institutional Strengthening Project. Assessment of the Dinas Kebersihan conversion will await completion of a GTZ-sponsored institutional analysis to be initiated in April 1998.

The Bengkulu Dinas Pasar was substituted for the Bogor project, and based upon field investigations it was determined to proceed immediately with this conversion project. MFP support to the process involves primarily in conducting the financial analysis and assisting in business planning. To guide the overall conversion process, a Standardized Financial Evaluations/Projections (SFEP) format was developed. This will assist in institutional evaluations by TK II governments that are considering the desirability and feasibility of transforming dinas to BUMD.

The SFEP consists of two phases. Phase I includes a preliminary analysis of the existing financial condition of the dinas from the perspective of its financial viability as a BUMD. This analysis is a "first-pass" screening of financial vitality and helps to identify major issues that must be addressed by the BUMD and PEMDA management. Phase II involves a more detailed, medium-term financial projection to determine the financial viability of the BUMD and to identify actions that are required to ensure the financial success of the BUMD (operating efficiency improvements, tariff increases, grant/subsidy requirements, assumption of existing debt, etc.).

This two-phase assessment also was conducted on five candidate service units in Ujung Pandang, and included Dinas Kebersihan, Dinas Parkir, Dinas Pasar, Dinas RPH (slaughterhouse) and Dinas Terminal. In a presentation to the BPRD in Ujung Pandang in late March 1998, the results of the assessment were presented, with a recommendation that the conversion process be initiated initially in four dinas (Parkir, Pasar, RPH, and Terminal). It is significant to note that the well-received presentation to the BPRD of the conversion strategy represented an important step to ensure positive community participation in strengthening local services and enhancing the prospects for improved cost recovery.

b. An MFP-sponsored national policy seminar on "Improving the Effectiveness and Efficiency of Local Government Expenditures" was conducted in Padang on September 22-24, 1997. The keynote presentation at the seminar was a paper by Frederick Colbourne, "Improving the Effectiveness and Efficiency of Local Government Expenditures." Conclusions from the seminar included the following: a) legalize the multi-year planning, programming and budgeting process (PJM) that includes attention to all major sectors, and promulgate preparation guidelines, including design standards and unit costing procedures, b) create incentives for improved performance in the use of central government grants and subsidies (SDO and INPRES) and in the use of local government funds (PAD/PBB), c) exercise caution in transferring higher level government functions and tasks to lower level government, but when transferring ensure that vertical splitting of responsibility is avoided, d) in this regard, revoke rules dividing responsibility for financing land acquisition, civil works/equipment, maintenance, and operation of facilities regarding road and drainage projects, e) central government should exercise caution in establishing new small kotamadya to ensure that there is no duplication of administrative functions, f) legalize the performance

oriented maintenance management system (POMMS) and further support its implementation, g) legalize the computerization of the existing accounting system (P3KD) and further support its implementation, h) promulgate operational guidelines for enhanced private sector participation in urban services, and i) develop a consistent approach to grants for the water supply sector designed to reward the best efforts of local government and avoiding rewards for poor performance. These recommendations are expected to set the general framework for concerted inter-ministerial efforts to improve the effectiveness and efficiency of local government expenditures during Repelita VII and will be an important input to the detailed policy agenda advanced by the CLEAN-Urban project (which was launched in January 1998).

MEDIUM TERM GOAL

9.3 *Support debt-financing of urban infrastructure and services via a market-based RDA and alternative debt facilities*

ACTION

9.3A Carry out external evaluation of the RDA's operations capacity, its working relations with local governments, capitalization policy and collection record. Prepare a 5-year institutional development plan for RDA.

4th YEAR TARGET

Initiate RDA strengthening activities if revised RDA/MOF decree promulgated.

ACCOMPLISHMENTS

Although the revised RDA/MOF decree was not promulgated during the fourth year, there was progress toward evaluating and strengthening the existing system of intergovernmental loans. To assist the Ministry of Finance in this regard, three separate analyses were conducted through MFP related to previous intergovernmental loan activities. The first was a portfolio analysis of the Regional Development Account (completed in October 1997). It found that over 80% of RDA lending goes to the water sector, that Java gets the biggest share of loans (although a certain increased geographical dispersal can be detected over the past couple of years), that RDA lending peaked at Rp 220 billion in 1994 (and has declined since then without a viable replacement), and that 34% of RDA loans are in arrears. While this level of arrears is a matter for concern, the analysis found that 70% of the loans are being fully repaid, and only a small group (10%) have not had any repayment made by the borrower. This suggests that the general characterization of RDA loans as "loans that don't need to be repaid" encompasses only a small portion of the portfolio, and that removing those would appreciably improve the overall repayment performance of RDA.

An analysis of the Subsidiary Loan Agreement (SLA) portfolio was completed in December 1997. It found that the bulk of SLAs have gone to one place (48% to Jakarta), that two-thirds of SLAs have gone to the water sector (slightly less than in the RDA portfolio), that like RDA loans under SLA reached a peak in 1994 and have declined since then, that the Asia Development Bank has been the biggest financial supporter of SLA (and its SLAs have the highest arrears) and that the overall arrear rate for SLA is higher at 38% than that of the RDA portfolio (but somewhat smaller than that of "pure RDA" loans at 40%).

The third analysis, completed in January 1998, examined "The Financial Condition and Loan Repayment Performance of PDAMs." It found that the debt coverage ratio is not rigorously used in RDA and SLA loan authorizations even though it is ostensibly the main financial selection criterion. Yet this alone does not explain the high level of arrears, and

thus cannot be used as an accurate predictor of loan performance. The addition of the debt to equity indicator does not substantially improve the predictability of arrears. Thus, it can be concluded that there is little relation between the financial condition of PDAMS and the extent to which they repay their RDA and SLA loans. It is probably more a function of "unwillingness" to repay rather than an "inability" to repay that explains the high level of arrears. These factors need to be considered in policies developed for strengthening both loan programs and to reduce the level of arrears.

Additional analysis of the RDA debt repayment mechanism is being conducted under the ADB-supported Institutional Strengthening of the RDA Project in BAKD/MOF.

ACTION

- 9 3B Support mechanisms for evaluating the credit worthiness of municipalities applying for RDA loans Establish routine internal MOF disclosure of local borrowers under RDA, terms of loans, and repayment records Implement procedures for imposing sanctions on municipalities that are in arrears on RDA loan repayments

4th YEAR TARGET

Preparation of implementation guidelines for new RDA if revised RDA/MOF decree is promulgated

ACCOMPLISHMENT

The revised RDA/MOF decree was not signed by the outgoing Minister of Finance (in March 1998) and has not been taken up by the new minister The onset of the financial crisis in the second half of 1997 was a notable factor in the delayed promulgation

ACTION

- 9 3C Support procedures for domestic (public and private) capitalization of the RDA, including reflows of outstanding loans under RDA management, GOI resources, and private market borrowing

4th YEAR TARGET

Implementation of enhanced capitalization of RDA

ACCOMPLISHMENT

In light of the delay in promulgation of the revised RDA decree, the level of capitalization of RDA is still under consideration by the GOI

ACTION

- 9 3D Explore alternative short-term and long-term mechanisms to mobilize domestic credit for local government financing of urban infrastructure investments (e g municipal bonds)

4th YEAR TARGET

Develop interim guidelines/manual for issuing revenue bonds

ACCOMPLISHMENTS

In November 1997, the MFP workplan (for the 4th Year) was revised to reflect the changed conditions in Indonesia's capital markets that precluded issuance of revenue bonds by local government units within the foreseeable future The Revenue Bond pilot project with PDAM Badung in Bali had been on course for an issuance prior to dramatic rise in short-term interest rates in late 1997 and the decline in available long-term investment funds

In October 1997, the Revenue Bonds Team conducted a site visit to PDAM Badung to assess the realistic possibilities of PDAM Badung proceeding with the planned issuance of a revenue bond for Rp 13.5 billion when conditions in the capital market stabilize The issuance had been temporarily suspended in June due to the creation of the new PDAM Denpasar which necessitated a split of assets and operations between PDAM Badung and PDAM Denpasar The trial split began as planned on July 1, 1997 and had three months of experience from which to project future operational and financial conditions in PDAM Badung Issues remaining to be resolved include the level of compensation to be paid by PDAM Denpasar to PDAM Badung, and who will be responsible for repayment of a Rp 22 billion French SLA for mechanical and electrical equipment associated with the estuary constructed by the Ministry of Public Works Upon satisfactory resolution of these issues, and in the context of a compatible capital market (interest rates for bonds in the 17-19% range), PDAM Badung, the Bupati of Badung and the Governor of Bali still intend to

proceed with the bond to finance much-needed investment in water distribution systems

To document the experiences to date with the revenue bond pilot project, a draft interim handbook on the revenue bond project was prepared by MFP. This handbook includes all of documents that were generated through the revenue bond project that will be useful to support future bond issuance efforts. These will be finalized by the Revenue Bond Team in May 1998 for dissemination.

Two other initiatives have been ongoing to mobilize alternative sources of financing for urban infrastructure: 1) creation of a Secondary Mortgage Facility (SMF) and 2) establishment of a low-income home purchase fund.

The creation of a Secondary Mortgage Facility received a major boost when the Minister of Finance, in late March 1998, signed the decree to establish the facility. The draft decree had been reviewed favorably by the Expert Staff of the Indonesia Monetary Board in April and May 1997, and then it was reviewed by Lembaga Keuangan (LK). In addition, LK was requested by the Minister to seek assurances from Bank Indonesia that it would structure sufficient protection into SMF in event of a primary lender default and to confirm that the decree was not in conflict with BI's new restrictions on property lending. Given BI's satisfactory response to these issues, LK recommended that the Minister sign the decree. The ADB's financial assistance in establishing the SMF which had been postponed for about a year because of the delays in issuing the ministerial decree has since been moved back on-line.

Also, the draft final report by consultant Marja Hoek-Smit, entitled "Indonesia Alternative Approaches to Low- and Middle-Income Housing Finance" was edited and finalized in July 1997, and conveyed to Biro P4PRP in Bappenas for action. Given the onset of the financial crisis in July and its impact on short-term and long-term borrowing rates, action on the report was deferred until financial conditions improve.

To assist PEMDAs and BUMDs to assess the comparative advantages of different financing options, a Financing Option Comparative Matrix and Decision Tree was developed by MFP. Draft materials were reviewed by DG PUOD/MOHA, BAKD/MOF, DirP3/MOF, the PURSE Project and USAID staff, and presented in the Pilot UMTF Urban Capital Investment Programming and Planning module from October 27 to November 7, 1997, and as a part of the Strategic Management course for PDAM President Directors on November 11-15, 1997. These materials were handed over to the CLEAN CLIN 1 team for further dissemination.

Also, a draft model to analyze PEMDA Tk II debt-carrying capacity based on the Polish Gmina Financial Analysis Model has been prepared by MFP. While it needs extensive modification to fit the budgeting and accounting practices under the IUIDP program, the PGFAM will address several deficiencies in the IUIDP planning process. It was conveyed to the CLEAN CLIN 1 team for field testing and modification.

II ESTABLISH A DECENTRALIZED AND COORDINATED SYSTEM FOR URBAN ENVIRONMENTAL MANAGEMENT (UPAP Objective 7)

This objective has at its core the utilization of increased local autonomy and the GOI decentralization process to improve urban environmental quality management (UEQM). This will be accomplished through the identification of environmental problems, the formulation and implementation of environmental policies (including the regulation of development through environmental impact assessments and through the use of economic interventions), the delivery of urban environmental services, and effective local planning practices.

MEDIUM TERM GOAL

7 3 *Improve infrastructure and service pricing mechanisms which introduce innovative economic incentives to enhance urban environmental quality*

ACTION

7 3A Formulate and implement improved pricing strategies for water sector services (water supply, groundwater extraction and wastewater collection, removal and treatment)

4th YEAR TARGET

No Target

COMMENTS

There was no target because the MFP-assisted activities in support of the end of the Repelita targets were completed during the third year. As a follow-up activity, MFP secured a local short-term consultant to revise and expand the December 1996 draft discussion paper on policy guidelines for pricing and financing of wastewater services. The Bahasa Indonesia draft was finalized in October 1997 and the English version was completed in November 1997 for dissemination. In addition, MFP lent initial support to planning a wastewater management conference in Bekasi, West Java for those provincial and local government with wastewater treatment plants. Owing to cutbacks in DIPs for research and workshops, the October conference was postponed.

MEDIUM TERM GOAL

7 6 *Develop and implement local urban environmental quality management (UEQM) strategies and programs as a part of UDP implementation*

ACTION

7 6A Develop and implement guidelines for more pro-active consideration of urban environmental quality management in the planning and programming of urban infrastructure development programs, especially in the preparation of IUIDP PJMs. Includes improved explicit analysis of consumer demand and willingness-to-pay as a basis for investment programming.

4th YEAR TARGET

No target

COMMENTS

Work on this action was completed in the third year of the UPAP.

III STRENGTHEN THE INSTITUTIONAL CAPACITY OF LOCAL GOVERNMENTS FOR URBAN MANAGEMENT (UPAP Objective 3)

MEDIUM TERM GOAL

3 2 *Develop a self-sustaining system for urban management training and technical assistance*

ACTION

- 3 2A Design and continuously maintain an inter-ministerial framework for urban management training and technical assistance This framework should be the basis and focal point for coordination of all ministerial and donor programs related to urban management training and technical assistance

4th YEAR TARGET

Quality control provided by NTC through alumni survey, monitoring of course delivery, and other inputs, emphasizing long-term institutionalization of UMTF

ACCOMPLISHMENTS

Throughout the year, NTC assisted Badiklat MOHA in the delivery of the UMTF Urban Management Core Course, which has now been delivered to groups representing all 38 medium-sized cities in the target group Alumni surveys for the Urban Financial Management module (done in year three) and the Urban Environmental Quality Management module have been conducted and analyzed These contributed important data for the "Interim Evaluation of the Urban Management Training Program" by Dr Anunuddin and Robert van der Hoff, which was presented in a one-day workshop in Jakarta on April 1, 1998 The interim evaluation looked at such matters as 1) adherence to the conceptual framework, cost-effectiveness, curriculum development, training delivery, and institutionalization of the UMTF It concluded that there ought to be no change in the menu of classes and that the original seven should be developed as initially planned If possible a single consistent and comprehensive Water Utility Management Course for PDAMs should be developed It also concluded that the UMTF course format is not yet fully consistent, largely because the course materials are the product of many different writers and still differ too much in design and style A streamlined and more consistent formatting should be undertaken Also, the UMTF case studies are not yet fully effective and need to be redone in order to meet several criteria, such as (a) testing the users' problem-solving and decision-making skills, (b) allowing for analysis of each single factor contributing to the solution, and (c) allowing the instructor to add or delete factors to put another "spin" on the case Also, the absence of course managers to oversee each course has considerably slowed down curriculum development The evaluation also found that there was course overload (too much material being covered in short span of time without opportunity for sufficient pre-training preparation by the participants) A lack of qualified and committed trainers was noted, and especially the inherent delivery deficiencies in Badan Diklat MOHA and the weak involvement of universities Several options for long term institutionalization of UMTF were examined, although no firm institutionalization strategy has been identified

ACTION

- 3 2B Implement urban management training program (UMTF) targeted at urban managers at the TK II level of government
- a Urban Management Core Course,
 - b Urban Financial Management Module,

- c Spatial Planning and Land Management course and Urban Environmental Quality Management Course,
- d Urban Infrastructure Capital Investment Planning and Programming Course

4th YEAR TARGETS

- a Urban Management Core Course conducted for remaining strategic cities and monitored by NTC
 - b Refresher TOT conducted and initial class conducted for UFM module
 - c Refresher TOT conducted for UEQM course and implementation plan completed
- Spatial Planning course curriculum developed
- d Curriculum developed, training materials prepared (and revised), training of trainers conducted, pilot training conducted, and potential implementation institutions identified for Urban Infrastructure Capital Investment Planning and Programming course

ACCOMPLISHMENTS

a As noted in 3 2A, all of the 38 strategic medium-sized cities have received UMCC training Overall, the UMCC has been delivered to representatives from 51 medium and large cities since 1995

b The Refresher TOT for the UFM module was conducted in Yogyakarta on August 6-8, 1997 to mark commencement of routine implementation by the Faculty of Economics at Gajah Mada University The first class of the UFM module was conducted in Yogyakarta on September 15-27, 1997 Since UGM received only 16 participants rather than the expected 40 to break even, it was necessary to use UGM faculty rather than external trainers to cut costs UGM does not have the resources to continuously upgrade the course materials and to involve resource persons from outside to assist with this process and in training delivery Thus, it is unclear if UGM will be able to routinely delivery the UFM as planned without additional support

c The UEQM training materials were improved by the revision of three topics (including the Case Study of Sustainable City Development and the Principles of Ecology in Manado, the Legal and Institutional Framework for Urban Enviromental Quality Management, and Managing Urban Solid Waste) and by the addition of a component on Preventing Urban Air Pollution The formal transfer of the UEQM module from the NTS to an implementing agency was completed The head of Badiklat MOHA gave support to transferring the UEQM module to Pusarpedal/Bapedal A field visit to the training facilities in January 1998 by a team including the Head of Badiklat, Head of BAKD/MOF, the NTC and select staff verified the suitability of the facilities for the proposed training A Refresher TOT was scheduled for later in 1998 The DIP budget to support implementation of the training was incorporated into Bapedal's DIP for 1998/99

The Urban Spatial Planning and Land Management module conceptual framework and curriculum outline were developed by short-term consultants, Dr Clyde W Forrest, University of Illinois, Urbana-Champaign, USA and Ir Wisnu Murti Ardjo, consultant and former head of spatial planning for Jakarta In December 1997, the draft framework was presented in a one-day workshop attended by 37 persons from central and local governments, universities, and consultant groups Like all UMTP modules, the USPLM seeks to link best practice internationally with the unique context of urban spatial planning in Indonesia The curriculum will focus primarily on the challenges of medium-sized cities, and emphasizes the need for participatory and demand-driven planning Cities selected to participate in the

training must have already gone through at least one UMTF module, be identified as one of the cities included in the 111 National Strategic Growth Areas (Kawasan Andalan), and be amenable to innovative approaches to USPLM. Based upon the results of the workshop, revisions were made to the curriculum outline and the process of training material preparation was initiated. The pilot training will take place later in 1998.

d. The conceptual framework and curriculum outline for the Urban Capital Investment Planning and Programming course (UCIPP) was prepared by the short-term consultant Hazel Ryon from the Research Triangle Institute. Following the curriculum outline development phase, local consultants were secured to prepare the training materials. A Training of Trainers (TOT) was held at Cipayang from September 10-12, 1997. The Pilot Training took place in Jakarta from October 27 to November 7, 1997, with 62 participants from 10 level I and level II governments, including the cities of Ambon, Kupang, Gorontalo, Palu, Ujung Pandang, and Bogor, and the districts of Bogor and Bandung. As part of the pilot training, participants visited the Sanitary Land Field at Bantar Gebang in Bekasi, and the planned development at Lippo Cikarang to see examples of government coordination of capital investments. Forty resource persons and facilitators from the Ministry of Finance, Ministry of Public Work, Ministry of Home Affairs, Bappenas, Tk II local government, Bappeda DKI, Menpera, universities, and consultant groups conducted the pilot training. Following the pilot training, additional revision of course materials was conducted, including Topic 7, "Assessment of Financial Condition of Local Government and BUMDs, and the addition of specific examples to strengthen several other topics such as "Project Identification and Prioritizing Applying Evaluative Criteria (Topic 4), "Capital Needs Assessment Maintaining Capital Asset Inventories and Demand Surveys (Topic 5), and "Jakarta Toward a Service City Within the CIP Framework (Case Study). Institutionalization of the UCIPP will be carried out in the fifth year of UPAP.

ACTION

3.2C Improved coordination and cooperation of regional universities and other management training institutions in developing and providing courses and programs relevant to development of urban managers.

4th YEAR TARGET

Involvement of regional universities and other management training institutions in course development and delivery (UFM, UEQM, and UCIPP).

ACCOMPLISHMENTS

As noted in 3.2B, UGM delivered the first training session of the Urban Financial Management module. Also, faculty from the University of Indonesia, Hasanuddin University, the Institute of Technology Bandung, and Andalas University have been regular contributors to preparation of training materials and presentations at TOTs, Pilot training, and delivery of the UMCC. Yet as the interim evaluation noted, one of the difficulties confronted by UMTF by being managed centrally from Jakarta is that there has not been sufficient attention to getting the regional universities and other partner institutes involved in developing and adopting new training programs.

Institutionalization of the PURSE-supported training on PPP is progressing as well. At the suggestion of the Chairman of the PURSE Technical Team, PURSE advisors met with executive of PERPAMSI on March 26, 1998 to discuss the possibility of PERPAMSI taking over the PURSE training program. Now under the leadership of the president director of PAM Jaya, PERPAMSI is planning to upgrade its services to PDAMs, including a more

active institutional development and employee training program

IV STRENGTHEN THE GOVERNMENTAL ADMINISTRATIVE APPARATUS FOR URBAN MANAGEMENT (UPAP Objective 2)

The central focus of MFEI-supported activities under this objective is for the GOI to rationalize the regulatory instruments for urban management promulgated by central ministries so that municipal governments will have a consistent set of mandates for guidance

It also seeks the creation and utilization of an effective inter-ministeria mechanism to coordinate urban policy development

MEDIUM TERM GOAL

- 2 1** *Strengthen inter-departmental and inter-governmental coordination in urban management*

ACTION

- 2 1B** Establish a full-time urban secretariat to support the inter-departmental coordinating committee

4th YEAR TARGET

Support interministerial urban forum to provide policy inputs to P4RPR

ACCOMPLISHMENTS

The interministerial "Urban Forum" established at Bappenas to brainstorm policy issues and to solicit inputs from various consultant teams such as the Municipal Finance Project, RDA Strengthening Project, PURSE, and IIUD was continued through the fourth year of the UPAP

MEDIUM TERM GOAL

- 2 3** *Develop a more coordinated system of laws, regulations and guidelines to support urban development*

ACTION

- 2 3A Complete and continuously update an inventory and analysis of existing laws, regulations and guidelines issued by central government ministries/agencies which are relevant to urban management at the Tk II level. Continuously advise responsible central ministries/agencies of gaps, overlaps and conflicts which need to be rectified

4th YEAR TARGET

Continuous operation

ACCOMPLISHMENT

Continuous updating of the inventory of laws, regulations and guidelines pertaining to local government carried out by MOHA

ACTION

- 2 3C Improve the existing systems for dissemination of central laws, regulations and guidelines to urban managers at the Tk II level of government

4th YEAR TARGET

Dissemination being carried out by MOHA

ACCOMPLISHMENTS

A "Replication Forum" was successfully conducted in Casarua Bogor on June 5-6, 1997. Fifteen targeted Tk II governments participated in the workshop, the objective of which was to draft 17 detailed cooperative city twinning agreements among 4 provider and 11 recipient local governments. These cooperative agreements were to be formally signed at the City Sharing and Twinning Workshop scheduled for late 1997 in Ujung Pandang, but owing to financial difficulties the workshop was rescheduled to May 15-16, 1998.

ACTION

- 2 3D Prepare detailed urban management guidelines (UMGs) on specific functions of urban management for use by Tk II urban managers These "technical guidelines" instruct Tk II managers in how to practically apply existing laws, regulations and guidelines for more effective urban management

4th YEAR TARGETS

- a Revision of urban environmental management technical guidelines completed (based upon Bandung case study) Dissemination initiated
- b Assist Bangkoto to prepare a reference document on laws, regulations, and guidelines pertinent to select aspects of new town development

ACCOMPLISHMENTS

- a A study by MFP II consultants PT INTERSYS Kelola Maju examined the linkages between national laws and regulations and local regulations of West Java Province pertaining to Kabupaten Bandung and Kotamadya Bandung to identify the structure of PEMDAs required to effectively implement national guidance in urban environmental management The Bandung case study was supplemented by documentation of innovative practices in Kotamadya Tangerang Dissemination was initiated in 1998 by Bangkoto
- b MFP II consultants PT Primakarya Adigunajaya prepared the reference document on laws, regulations and guidelines for new town development under the guidance of an interministerial Working Group organized through Bangkoto The draft reference document was completed in December 1997, and reviewed by the Working Group in January 1998, with assistance from Jabotabek government leaders who had experience with new town development Final changes are being incorporated into the document and dissemination is scheduled for 1998

V IMPLEMENT A DECENTRALIZED AND COORDINATED PROCESS FOR THE PROVISION AND MANAGEMENT OF URBAN INFRASTRUCTURE FACILITIES AND SERVICES (UPAP Objective 5)

The purpose of PURSE-supported activities under this objective is to clarify the technical standards for urban infrastructure design, instruction and operation in order to facilitate enhance private sector participation in local enterprises

MEDIUM TERM GOAL

- 5 3 *Strengthen the Planning and Management of Urban Infrastructure and Service Delivery*

ACTION

- 5 3E Update, improve and implement minimum acceptable technical standards for design, construction and operation of sanitary land fills or other solid waste disposal technology (as appropriate) Improved standards and documentation will provide the technical basis for contracting PSP/PPP

4th YEAR TARGET

No target (this was dropped from the PURSE workplan)

COMMENT

The draft solid waste management regulations and guidelines have been completed since 1995, but they have not be acted upon by the Ministry of Public Works

ACTION

- 5 3F Update, improve and implement regulations providing minimum technical standards

for the design, construction and operation of wastewater treatment systems Improved standards and documentation will provide the technical basis for contracting PSP/PPP

4th YEAR TARGET

No target (this was dropped from the PURSE workplan)

COMMENT

A draft regulation was begun in 1996 and the PURSE team provided an issues paper to the Ministry of Public Work on this matter This matter was not taken up by the DG Cipta Karya Technical Review Committee because of other priorities

ACTION

5 3G Update, improve and implement regulations requiring real estate, commercial and industrial developers to construct and maintain environmental infrastructure (e g water and wastewater systems) as part of their developments

4th YEAR TARGET

No target (dropped from the PURSE workplan)

COMMENT

No activities took place on this action over the past two years owing to a redirecting of priorities in the PURSE project

VI MOBILIZE PRIVATE SECTOR AND COMMUNITY PARTICIPATION IN URBAN DEVELOPMENT (UPAP Objective 12)

This objective involves activities that sustain enhanced private sector participation in urban services development and delivery

MEDIUM TERM GOAL

12 1 *Expand private sector participation in the provision of urban environmental infrastructure and services*

ACTION

12 1 Develop project risk management system for BUILD-OWN-OPERATE (BOO) and BUILD-OPERATE-TRANSFER (BOT) project development and financing

4th YEAR TARGET

Dissemination of completed risk management manual to Tk II level officials and training in risk management

ACCOMPLISHMENTS

The revised translation of the Bahasa Indonesia version of the PURSE Risk Management System Handbook was completed in December 1997. The RMS Handbook was printed in a two-language book format and disseminated to over 90 local government and PDAM officials. By November 1997, five pilot training sessions on the RMS Handbook had been completed so that over 100 local government and PDAM officials had been trained in the essentials of risk management. With the final pilot training program scheduled for April 1998, PURSE will shift to an "on-the-job training" approach by providing support directly to those PDAMs involved with PURSE as demonstration projects. It is anticipated that the Risk Management System Handbook will be legalized for PPP water projects and become the guiding procedures through the PPP Center that will be established later in 1998.

ACTION

12 1B Institute financial guarantee mechanisms to support local government initiatives in BOO/BOT projects

4th YEAR TARGET

Conduct a workshop on lessons learned on financial constraints to demonstration projects and make final recommendations to government on alternative or creative credit enhancement mechanisms to support PPP.

ACCOMPLISHMENTS

While the initial target of conducting a workshop on lessons learned was dropped from the PURSE workplan in early 1997, owing to the onset of the financial crisis in July 1997 the issue of credit enhancements became a renewed priority for assessment. PURSE prepared a draft issues paper on the development of financial guarantees and credit enhancements, and held preliminary discussions with Bappenas on which alternatives would best address the current financial situation. It is intended that follow-up on this issue will be done through the IQC team charged with establishment of the PPP Center and in coordination with the MFP II and CLEAN projects.

ACTION

12 1C Select and implement appropriate public private partnership projects as PURSE demonstration projects

4th YEAR TARGET

Assist 4 new demonstration projects through project identification and feasibility stages. Advise 2-3 existing projects during contract negotiations.

ACCOMPLISHMENTS

PURSE worked with a total of 11 separate water projects in varying ways during the fourth year, with the total value of contracts signed in PURSE-supported demonstration projects vastly exceeding the \$125 million target. With three signings in Jakarta and Medan valued at \$1.3 billion, and a signing in Semarang for \$45 million, the four contracts already exceed the overall UPAP targets. PURSE has been assisting the negotiations between PDAM Malang and Bewater for a partial concession contract. Estimated at \$85 million, the Malang contract is expected to be signed later in 1998.

Demonstration project status by the end of the 4th year is as follows:

Balikpapan - Private party has withdrawn interest and PURSE is dropping the project.
Semarang - \$45 million project underway.

Jakarta - The concessions to PAM Jaya East and PAM Jaya West were officially initiated February 1, 1998 and all but two of 21 CPs in Project Life Cycle have been met.

Palu - PURSE withdrawing from due to lack of viability of PPP.

Medan - Financial closure reached.

Surabaya - Private party proposal inadequate so PDAM lacks a qualified partner.

PURSE may drop this project.

Padang - Change in demand due to competing investment from public sector threatens the viability of the PPP.

Pontianak - Draft documents prepared for tender.

Cirebon - Private party and PDAM seeking to identify water source.

Malang - Contract negotiations underway.

Manado - PDAM agreed to a competitive tender process and preliminary project identification is underway.

ACTION

12.1D Establish a legal and regulatory framework to enable private firms and local governments to implement public-private partnerships in priority urban services (water, wastewater, and solid waste management) with an appropriate balance of autonomy from and oversight by central government ministries.

4th YEAR TARGET

Multisectoral government regulation (PP) on the development and implementation of public-private partnerships in infrastructure prepared and promulgated.

ACCOMPLISHMENT

The new law was issued as a Presidential Decree (Keppres) No. 7 of 1998 and not as a Government Regulation, or Peraturan Pemerintah (PP) on January 12, 1998. An important element of the new PPP law is the strong emphasis on the competitive process for selecting private sector partners and transparency in implementing PPP projects. PURSE began reviewing the impact of the new law on PURSE products, such as the Project Life Cycle.

ACTION

12.1E Develop technical guidelines and operational procedures for planning, implementing and operating public/private partnerships.

4th YEAR TARGET

Project Life Cycle Operations Manual and Model Documents completed, translated and disseminated as government documents.

ACCOMPLISHMENTS

The English version of the Project Life Cycle was finalized in December 1997, and the Bahasa Indonesia version was also completed. Dissemination occurred in early 1998. Possible revisions of the Project Life Cycle will be studied in light of the new PPP presidential decree. Also, it remains a high priority of PURSE to institutionalize the Project Life Cycle within the soon to be established PPP Center.